

Credit quality recovers, sustainability key

Ratings Round Up, First Half Fiscal 2017



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Ratings

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Executive summary

An analysis of rating actions in the first half of the current fiscal shows credit quality of India Inc has improved, but sustainability of this trend will be the key given the several headwinds that India Inc continues to face.

For the first time in the last 10 semi-annual periods, the debt¹-weighted credit ratio rose above 1, which underscores value of debt upgraded is more than those downgraded, and surged to 2 times in the first half of fiscal 2017 compared with 0.2 time in the second half of fiscal 2016. The credit ratio (number of upgrades to downgrades) came in at 1.2 times compared with 0.8 time.

This is also the first time in the last 10 semi-annual periods that both these ratios have been above 1 simultaneously.

The significant change this time was the decline in the value of debt downgraded. At ~Rs 0.4 trillion in the first half of this fiscal, it is the lowest and only a fourth of the Rs 1.4 trillion average of the past 10 semi-annual periods. The reason for this was less intense pressure on commodity-linked sectors, especially metals, following stabilisation of prices and policy support in the form of anti-dumping duty and minimum import price from the government.

There were 646 upgrades to 553 downgrades in the first half. Upgrades were concentrated in the domestic consumption-linked sectors such as auto ancillaries and packaging, and in the exports-linked pharmaceutical sector. Downgrades were mainly in the investment-linked sectors such as construction, industrial machinery, real estate and metals. Financial (capital structure, debt protection and liquidity) and business (demand, profitability and working capital cycle) reasons contributed equally to rating actions.

The focus now shifts to the sustainability of the improvement in credit quality. The investment cycle is yet to pick up, there hasn't been a material deleveraging in corporate balance sheets, and weak assets continue to mount in banking. To boot, global growth is also weak. Fresh rate cuts by the Reserve Bank of India, their transmission by banks, government's continuing policy support, pace of implementation of reforms, and any sharp swings in rupee against the US dollar will be the other key monitorables.

CRISIL expects the overall credit ratio to stay above 1 in the near term led by an expected rural leg-up to private consumption following a near-normal monsoon. However, debt downgrades in value terms is expected to be more in the second half because of continuing pressure on the investment-linked sectors.

CRISIL continues to remain focussed on the quality of ratings and strives to minimise sudden and sharp rating actions. Sharp and sudden rating actions (upgrades as well as downgrades) from high rating categories ('A-' and above) are not considered desirable as investors expect these categories to display high degree of stability. Of the 87 rating actions on 1,038 firms in the 'A-' and above categories, around 95% were single notch² or low intensity.

¹ Debt outstanding on the books of the firms, excludes financial sector players

² Excludes ratings placed on 'Rating Watch', which is used to convey to investors that the rating is being monitored for certain critical events and that additional information is awaited. This helps reduce the possibility of any surprise for the investors.

About CRISIL's Ratings Round-Up

CRISIL's Ratings Round-Up is a semi-annual publication that analyses CRISIL's rating actions and traces linkages between the actions and the underlying economic trends and business factors.

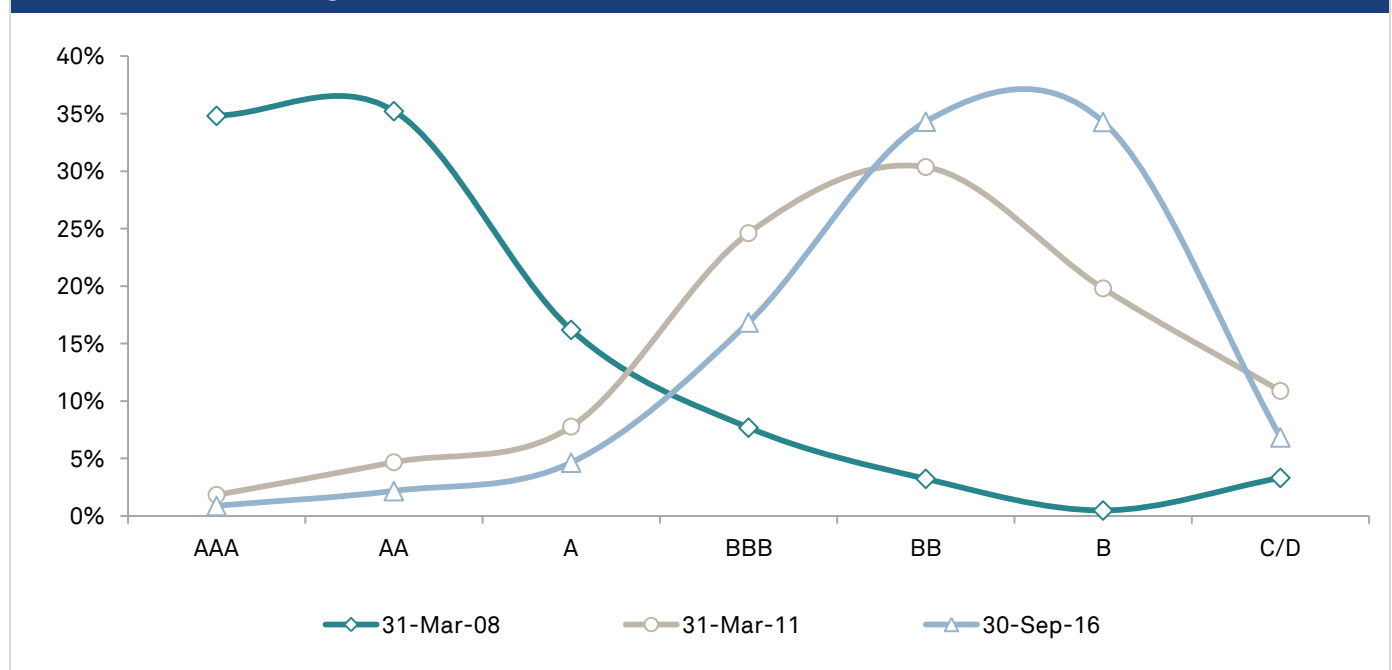
A credit rating is an opinion on the likelihood of timely debt repayment. Therefore, an analysis of rating actions in a large and diverse portfolio of rated firms is an apt indicator of economic prospects.

This edition analyses CRISIL's rating actions in the six months ended September 30, 2016.

CRISIL's portfolio of outstanding ratings has stabilised

CRISIL's portfolio of outstanding ratings has stabilised – with ratings on 13,869 firms outstanding as on September 30, 2016, more than three-fourths of which are rated 'CRISIL BB' or lower. Consequently, the median rating stayed put at 'CRISIL BB' over the past four-and-a-half years ended September 30, 2016 -- down from 'CRISIL AA' on March 31, 2008 (*Chart 1*).

Chart 1: CRISIL's rating distribution



Source: CRISIL

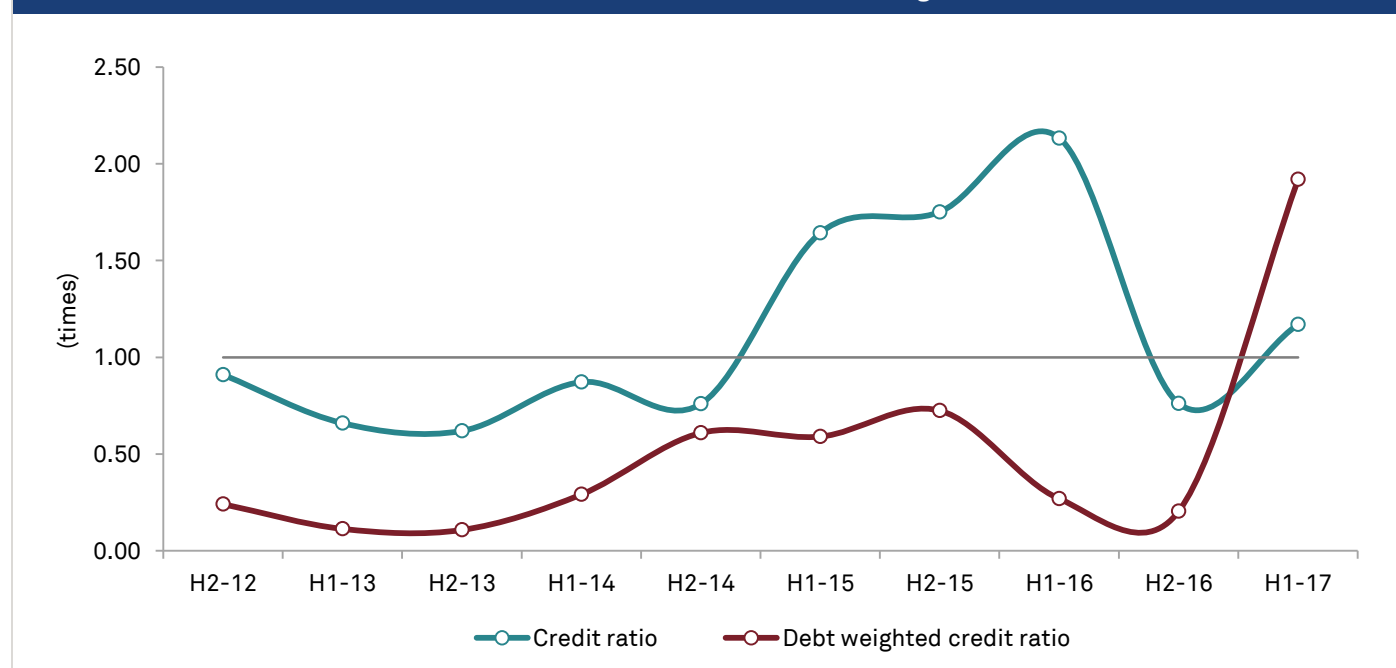
The credit ratio and the debt-weighted credit ratio have improved

Sustained growth in private consumption and substantial pick-up in government consumption more than offset continuing weakness in private investments and headwinds in exports, helping India's GDP to grow over 7% in the first half.

For the first time in 10 semi-annual periods, the debt-weighted credit ratio rose above 1, which underscores value of debt upgraded is more than those downgraded, and surged to 2 times in the first half of fiscal 2017 compared with 0.2 time in the second half of fiscal 2016. The credit ratio came in at 1.2 times compared with 0.8 time (*Chart 2a*).

This is also the first time in 10 semi-annual periods that both these ratios have been above 1 simultaneously.

Chart 2a: Semi-annual trends in the credit ratio and the debt-weighted credit ratio



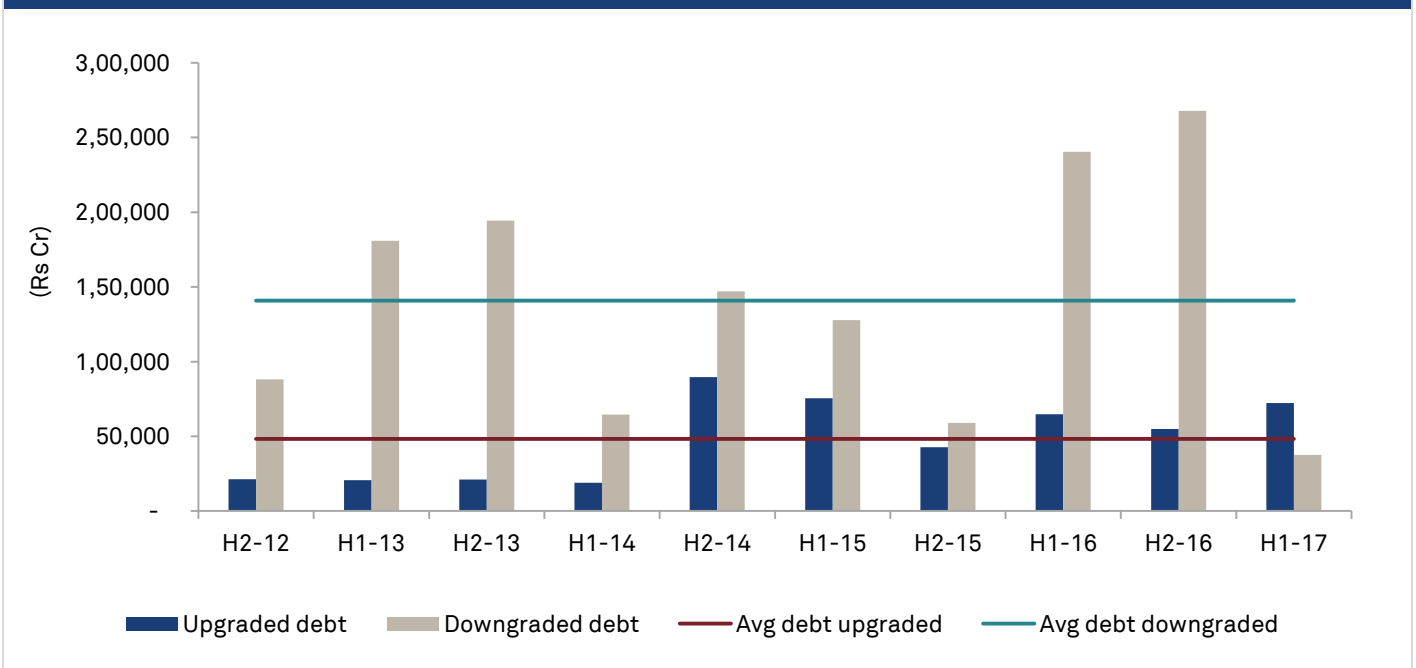
Source: CRISIL

As the *Chart 2b* below shows, there was a sharp decline in the quantum of debt downgraded. At ~Rs 0.4 trillion in the first half, it is the lowest and just a fourth of the Rs 1.4 trillion average of the past 10 semi-annual periods. And the value of debt upgraded was ~Rs 0.7 trillion, better than the ~Rs 0.5 trillion average of the past.

Here it is imperative to note that these figures may not be entirely reflective of the entire banking system since they do not include some major corporate houses with high indebtedness such as Essar, GVK, Jaypee and Videocon. CRISIL does not have ratings on most of them and hence, our analysis does not incorporate them.

Ratings

Chart 2b: Semi-annual trends in debt upgraded and downgraded



Source: CRISIL

Overall private investments remained muted due to excess capacity and high leverage across firms. However, the government's push led to some pick-up in orders for construction and engineering firms involved in road projects. The fall in private investments was also in sync with the continuous decline in the production of capital goods, which weighed down the Index of Industrial Production (IIP). Exports remained weak with major markets such as the European Union, the UK and the US continued to grapple with sluggish growth.

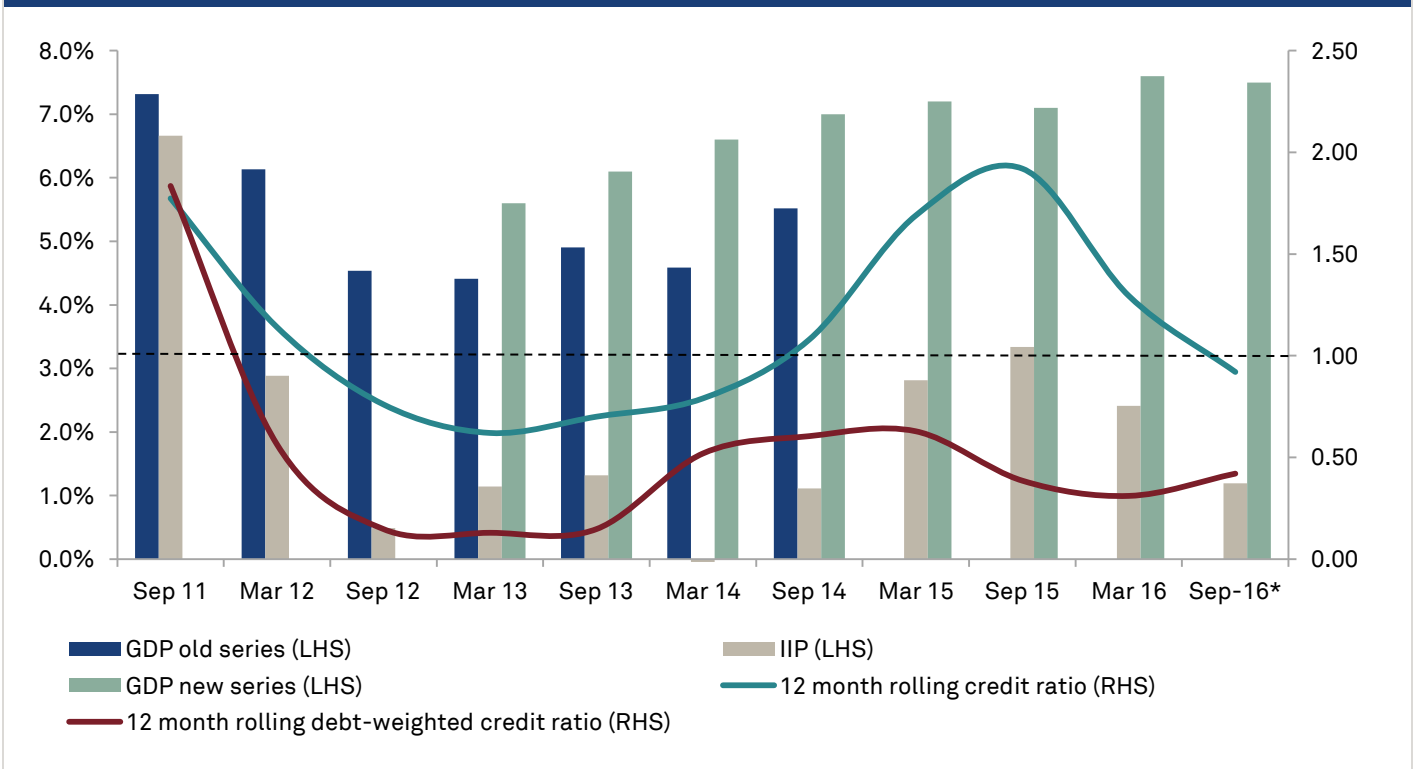
The credit ratio trends (*Chart 2c*) exhibit strong correlation with economic indicators. Firms in the consumption-linked sectors continued to witness relatively better credit quality because of steady growth in private consumption and the recent spurt in government spending. However, sustained industrial recovery is not yet on the horizon as indicated by the IIP, which declined in the first half. So credit quality, especially for investment-linked sectors remained under pressure.

The large amount of downgrades (both in number and by debt value) in fiscal 2016, especially the second half, led by the metals sector kept the overall credit ratio and the debt-weighted credit ratio below 1 on a 12-month rolling basis (October 2015 – September 2016; *Chart 2c*). The substantial improvement in the debt-weighted credit ratio during April-September 2016 helped burnish the 12-month rolling average as on September 30, 2016, to 0.4 time compared with 0.3 time on March 31, 2016.

However, the improvement in credit ratio during April-September 2016 wasn't enough to support the 12-month rolling credit ratio, which declined to 0.9 time as on September 30, 2016, compared with 1.3 times on March 31, 2016 (*Chart 2c*). This was mainly on account of the substitution of a period of relatively high credit ratio (2.1 times in the first half of fiscal 2016) with a period of lower credit ratio (1.2 times in the first half of fiscal 2017).

For broad-based recovery, both the 12-month rolling ratios (credit ratio and debt-weighted credit ratio) should exceed 1 time. Currently, they do so only on a six monthly basis.

Chart 2c: 12-month rolling credit ratio and debt-weighted credit ratio, IIP and GDP[#]



[#] GDP and IIP growth numbers are on 12 month rolling basis

*GDP growth rates are based on CRISIL's estimates for 2016-17, and for IIP are based on July 2015 to July 2016 period

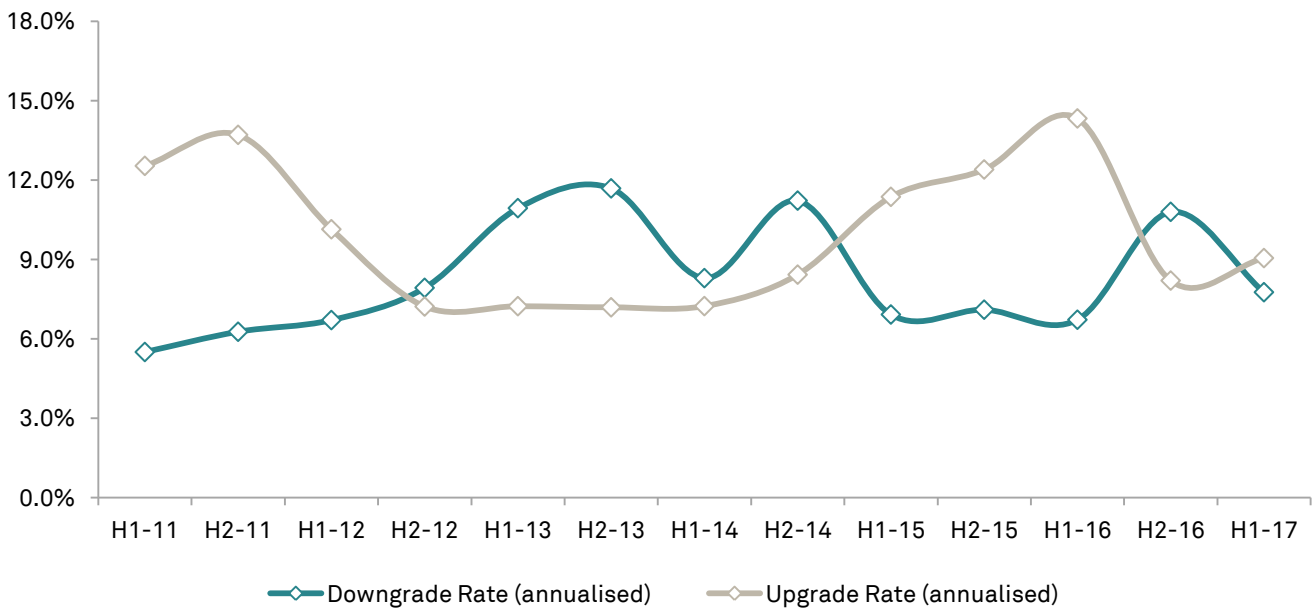
Source: CRISIL

Downgrade rate declines, upgrade rate inches up

CRISIL's rating portfolio for the first half witnessed 646 upgrades compared with 553 downgrades. The downgrade rate slowed to 8% from 10.8% in the second half of last fiscal led largely by a stabilisation in metal prices at lower levels and policy support in the form of anti-dumping duty and minimum support price by the government. Around three-fourths of the downgrades in the first half were from 'CRISIL BB' or lower rating categories. On the other hand, the upgrade rate inched up to 9.1% from 8.2% on the back of better domestic growth prospects.

The credit quality of investment-linked firms continued to be under pressure on account of low demand caused by delay in the investment cycle and leveraged balance sheets, though healthy order-book growth in the road sector led to upgrades for a few construction and engineering firms. Sluggish global demand continued to constrain export-oriented firms. Only companies belonging to sectors which had inelastic demand, such as pharmaceuticals, bucked the trend.

Chart 3: The swerve in rating action



Source: CRISIL

Most action in higher rating categories continue to be of low intensity

Sharp and sudden rating actions (upgrades as well as downgrades) from high rating categories ('A-' and above) are not desirable; investors expect them to have a high degree of stability. Sharp changes lead to huge cliffs (in terms of returns) for investors, leaving them with little scope to manage their exposure.

CRISIL's portfolio witnessed rating actions on 87 firms in the 'A' and above categories out of a portfolio of 1,038 firms in these rating categories. Only five³ of these were multi-notch changes (high intensity) while the rest were all single notch (low intensity).

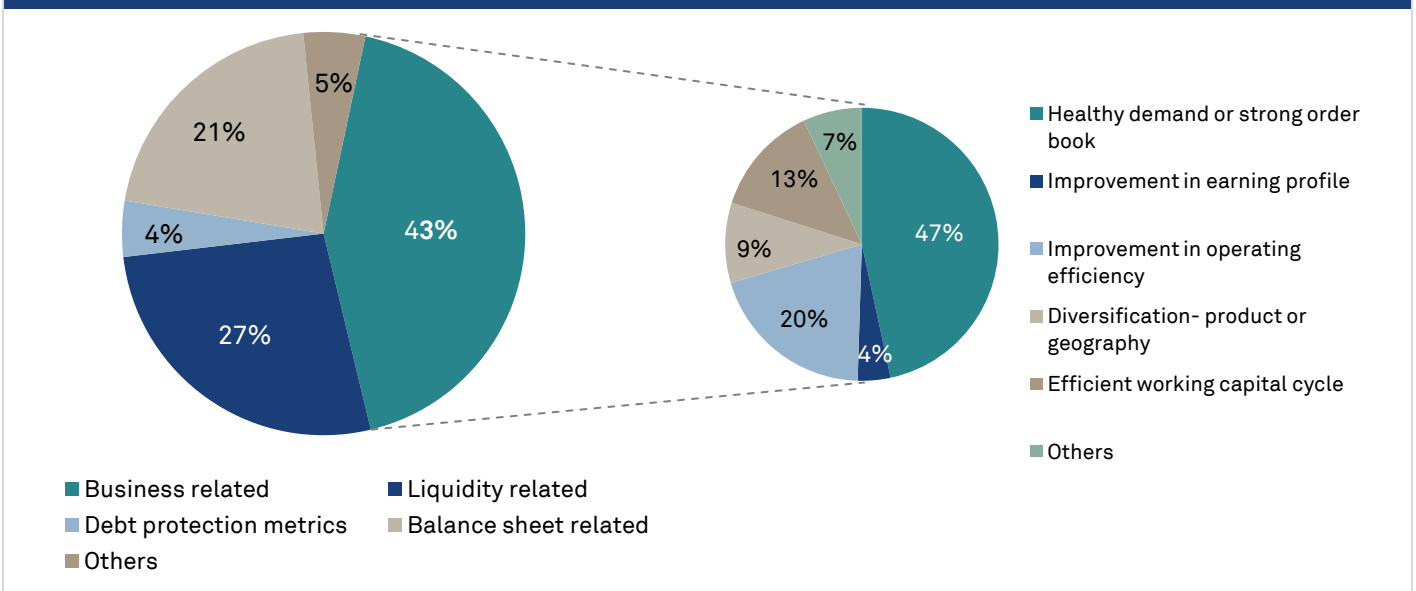
³ Excludes ratings placed on 'Rating Watch', which is done to convey to investors that the rating is being monitored for certain critical events and that additional information is awaited. This helps reduce the possibility of any surprise for the investors.

Rating actions driven almost equally by financial and business reasons

CRISIL's analysis of rating actions for the first half of the current fiscal indicates that half of the upgrades were driven by improvement in financial risk profile – that is, capital structure, debt protection metric and liquidity. Business-related factors such as healthy demand, improved operating margins and efficient working capital management were responsible for most of the rest (*Chart 4a*).

Upgrades were primarily led by consumption linked sectors such as automotive components and packaging. These upgrades were largely on account of business reasons such as better demand and high operating profitability.

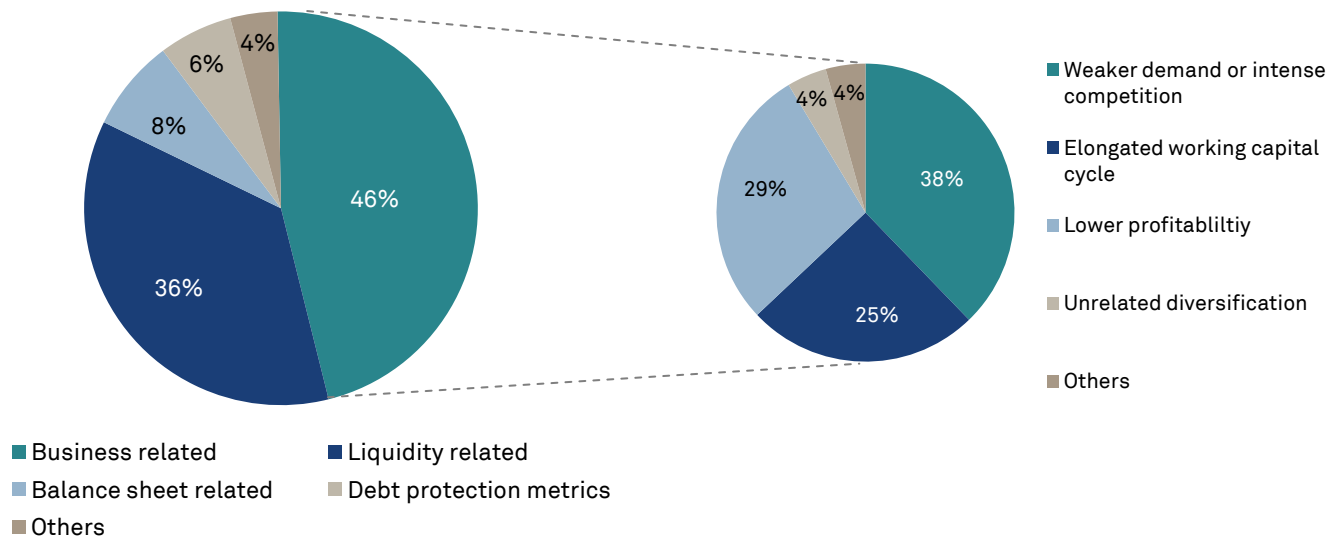
Chart 4a: Reasons for upgrades



Source: CRISIL

In contrast, investment-linked sectors such as construction, industrial machinery and real estate continued to dominate downgrades led by business-related reasons such as sluggish demand, stretched working capital cycles and pressures on profitability. Business-related reasons accounted for close to half of the downgrades (*Chart 4b*). The other half were attributable to deteriorating financial performance including – stress on balance sheet, lower cash accrual and weak liquidity.

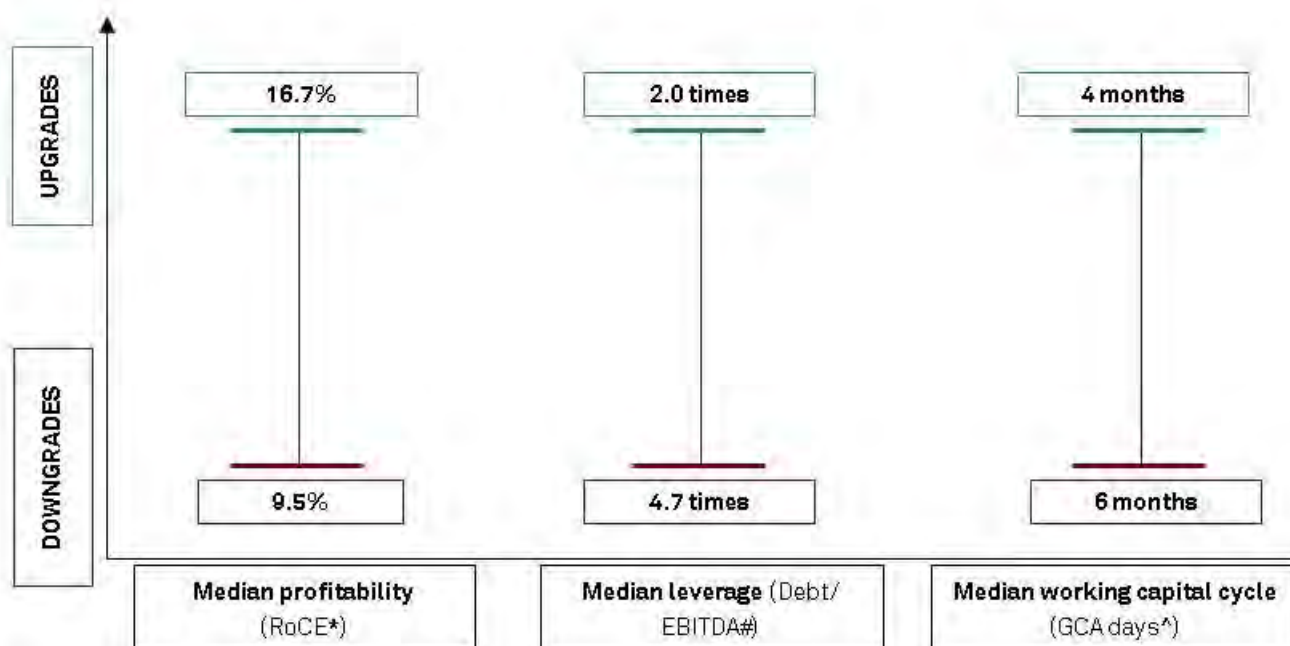
Chart 4b: Reasons for downgrades



Source: CRISIL

In the first half of the current fiscal, firms upgraded continued to display distinctly better profile compared with those downgraded. Upgraded firms, in general, had higher profitability, lower indebtedness and better working capital management. This is reflected in the wide gap between the median of these parameters for upgraded and downgraded firms (Chart 4c)

Chart 4c: Median financials of firms that witnessed rating actions



*RoCE: Return on capital employed

#EBITDA: Earnings before interest, depreciation and amortisation

^GCA: Gross current assets

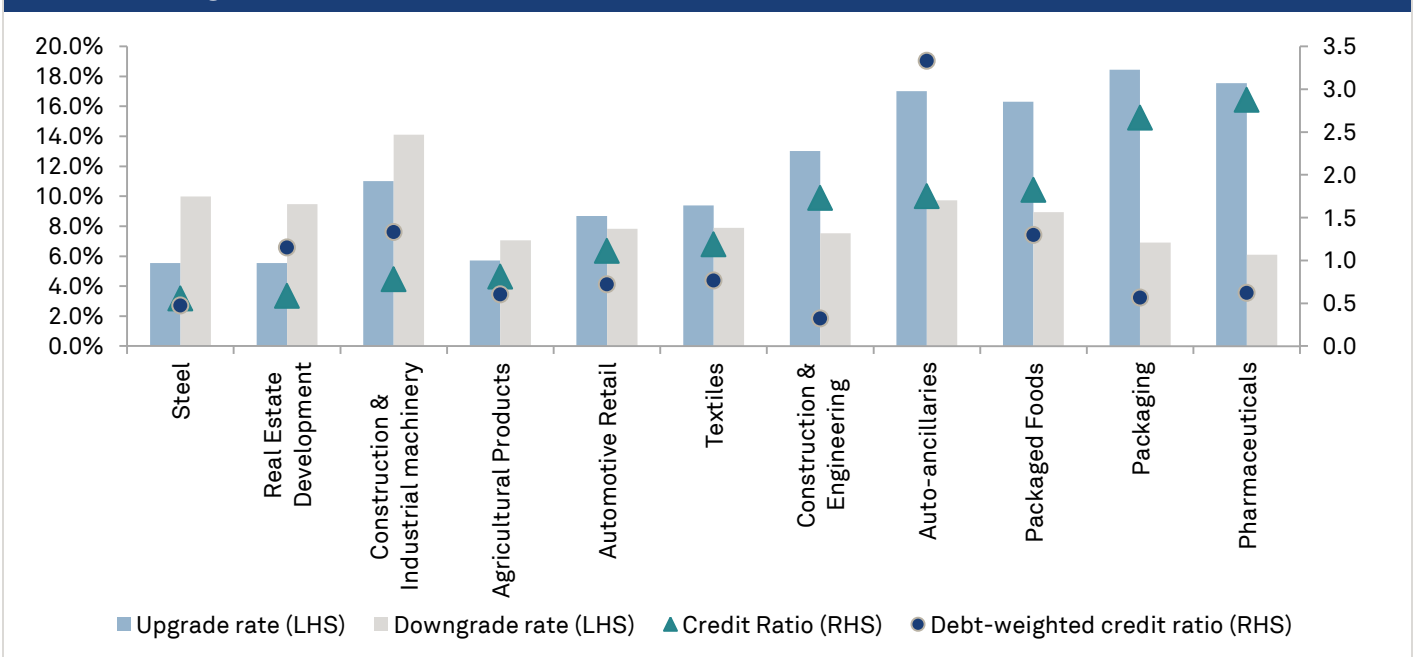
Source: CRISIL

Consumption-linked sectors continue to outshine

Domestic consumption-linked sectors continued to outperform in the first half of the current fiscal, while pharmaceuticals was the only export-linked sector showing resilience amid slowing global growth. Investment-linked sectors continued to face challenges of high leverage and delay in pick-up of investment cycle. Upgrades from this sector were mainly in firms which were involved in construction and engineering of road, which saw healthy growth in order book. These orders were primarily driven by increased government focus on this sector.

Commodity prices, especially energy and metals, after seeing a sharp decline in the last two years, seemed to have stabilised at lower levels, which reduced the pain for those with highly leveraged balance sheets. Though downgrades in the metal space continue to outnumber upgrades, the rate of downgrades has declined sharply from last fiscal, especially second half – the downgrade rate in the first half of current fiscal was 8.5% compared with 15% for the whole of last fiscal and 17% in the second half (*Chart 5*).

Chart 5: Rating actions of top 11 industries



Source: CRISIL

Consumption-oriented sectors such as auto ancillaries and packaging continued to see more upgrades than downgrades driven by healthy demand. Auto ancillaries saw more orders from medium and heavy commercial vehicles and cars.

The pharmaceuticals sector witnessed 3 upgrades for every downgrade. Demand remained robust from both the domestic and export (especially US) markets. This, along with sustenance or improvement in operating profitability, had driven most of the upgrades in this sector.

Textiles was a mixed bag, with majority of upgrades belonging to ready-made garments led by improving domestic demand. Downgrades, on the other hand, were mainly among cotton yarn producers because of pressure on profitability emanating from lower realisations.

The real estate sector continued to be in the doldrums with ~2 downgrades for every upgrade. Upgrades were limited to firms, mainly special purpose vehicles (SPVs) that were nearing project completion and had seen significant traction in sales. On the other hand, downgrades continued in residential development sector and were driven by project delays and inventory pile-ups coupled with high debt as demand remained subdued.

The steel sector continued to see more downgrades than upgrades in the first half of the current fiscal due to subdued demand, both domestic (from investment-linked sectors) and global, lower realisations and high debt of companies (taken to expand capacities prior to the sharp decline in prices). The downgrade rate declined in the first half of current fiscal compared with the whole of last fiscal. The median debt-to-EBIDTA of downgraded firms is still more than twice that of upgraded firms, although the quantum of debt has significantly reduced with large firms downgraded last fiscal seeing some stability. Of the debt downgraded last fiscal, the steel sector accounted for ~40%, compared with just 2% in the first half of the current fiscal. This was mainly on account of the stabilisation of prices and the policy support in the form of minimum import price (MIP) and anti-dumping duty. Upgrades were primarily in firms that had healthy balance sheets and those that benefited from MIP.

Credit growth up a tad, faster rise seen in the second half

Bank credit growth (*Table 1*) increased marginally year-over-year driven by the retail segment. However, corporate loan offtake continues to be sluggish as credit demand from investment-linked sectors and from companies reeling under high debt remained weak. The asset quality of banks, too, remained under pressure, which slowed lending growth for banks.

However, money raised through commercial papers (CP) increased ~38% between April and August 2016 year-on-year as top-rated corporates continue to access money markets to meet their short-term needs. While the Reserve Bank of India (RBI) has reduced its policy (repo) rate by 150 basis points (bps), since January 2015, base rates of banks have fallen only by 60 bps. This, along with better liquidity, widened the differential between bank rate and market-determined interest rate, leading to a surge in commercial paper issuances.

CRISIL expects better bank credit growth in the second half of this fiscal compared with the first primarily from retail credit growth supported by expected improvement in rural demand on the back of good monsoon.

The differential between capital market rates and bank rates are expected to narrow owing to the transmission of past rate cuts and the shift to marginal cost of funds based lending rate (MCLR). Signs of these are visible with deposit rates and G-sec yields trending lower in August 2016 supported by ample liquidity. However, the payout of \$20 billion outflows of foreign currency non-resident deposits (FCNR), advance tax payments and spectrum auctions in October 2016 may drain liquidity temporarily and clog monetary policy transmission in the third quarter of this fiscal.

Table 1: Trends in industrial activity and fund mobilisation

Quarter ended	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Bank credit growth (%)	17.8	14.5	14.6	13.1	10.6	10.5	10.2	9.3	9.6	10.6	11.0	9.4	9.3*
Repo rate (%)	7.50	7.75	8.00	8.00	8.00	8.00	7.50	7.25	6.75	6.75	6.75	6.5	6.5
Credit spreads (%) #	0.9	0.5	0.6	0.4	0.4	0.4	0.4	0.5	0.4	0.4	0.6	0.6	0.4**
ECB mobilised (\$ billion)	9.4	8.7	9.6	6.5	4.2	6.9	7.5	6.3	5.5	8.3	4.3	2.7	4.4@@
Equity mobilised (Rs billion)β	120.1	184.1	150.7	197.1	238.0	89.1	164.4	304.9	157.1	317.9	112.7	211.7	NA
IIP growth (% YoY)	1.9	-0.8	-0.4	4.5	1.3	2.0	3.3	3.3	4.8	1.7	0.2	0.6	NA
GDP growth (% YoY)^	7.7	6.0	6.7	7.5	8.3	6.6	6.7	7.6	7.7	7.3	7.7	7.1	7.5^^

*Updated as on Sept 16, 2016; **Updated as on Aug 2016; #AAA spread over 10-year G-secs; @@ Updated till Aug 2016

^ As per new GDP series; ^^ As per CRISIL's estimates; β Equity mobilised includes right issues, IPOs and FPOs; NA: Not available

Source: CRISIL

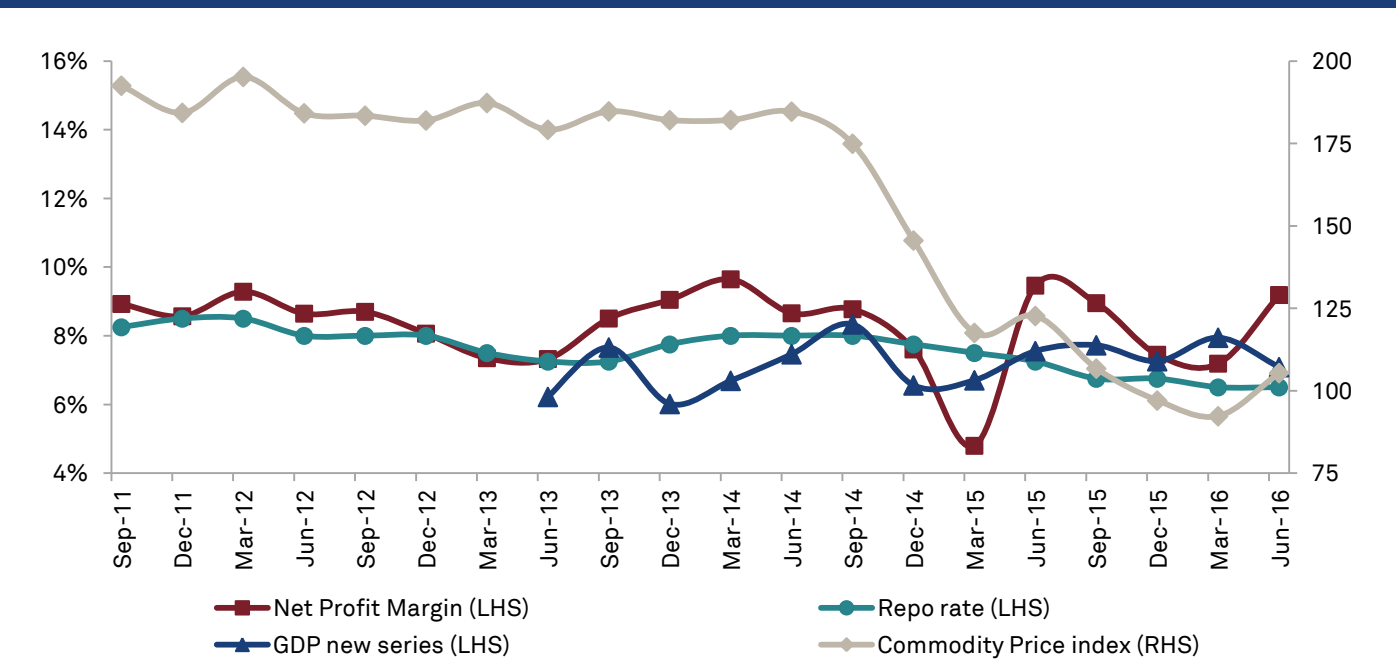
Topline falls, profitability rises on lower commodity prices

CRISIL's analysis of the financial performance of 371⁴ firms in the CNX 500 index shows net profit margin (NPM) improve to 9.2% in the first quarter of the current fiscal (sequential basis) driven by lower input costs stemming from low and stable commodity prices. Energy and metal prices, which have been on the decline for the last two years, have stabilised at lower levels. Though this helped improve profitability sequentially, it also led to a decline in topline (since these companies are just converters of raw material) compared with the preceding quarter.

The topline of firms associated with investment-linked sectors also declined during this period due to slower pace of execution and flow of orders. Profitability was also under pressure due to higher fixed and interest costs (Chart 6).

We expect better revenue growth and improved profitability for firms in the consumption-linked sectors over the near-to-medium term supported by domestic demand growth. Firms from the investment-linked sectors are expected to see a gradual improvement in topline and profitability as order flows improve with a pick-up in investment cycle expected towards the end of this fiscal.

Chart 6: Net profit margin and commodity prices



Source: CRISIL

⁴ These listed companies have reported results for the quarter ended June 30, 2016, and have remained in the S&P CNX 500 for the past 16 quarters. Oil refining and marketing companies have been excluded because their reported numbers would have skewed the sample. Companies from the financial sector have also been excluded.

Sluggish global growth to weigh on exports

The World Trade Organisation (WTO) has sharply lowered its trade growth forecast for calendar year 2016 to 1.7% from 2.8% earlier because of its sluggish global GDP growth forecast of 2.2%.

The pace of decline in India's exports slowed this fiscal because of growth in sectors such as gems and jewellery, and chemicals compared with last year. It is expected to be sometime before a sustained recovery is seen, given the global growth forecast. *Table 2* shows growth rates for India's key trade partners.

Table 2: GDP growth rates

Countries	2014	2015	2016(P)	2017(P)
Eurozone	1.1	1.9	1.6	1.4
UK	3.1	2.2	1.8	1.0
US	2.4	2.4	2.0	2.4
China	7.2	6.9	6.6	6.3

Source: Standard & Poor's

The fallout of the UK's decision to exit the European Union – or the so-called Brexit -- is likely to lower GDP growth in both the Eurozone and the UK in calendar years 2016 and 2017. Apart from the US, real GDP growth in the other key trade partners is seen declining. Additionally, sharper-than-expected slowdown in China, and higher volatility in capital flows and exchange rates due to divergent monetary policies across the globe, will continue to be the key monitorables.

CRISIL expects export growth to remain tepid through calendar years 2016 and 2017 given the forecast on global growth. Only specific sectors such as pharmaceuticals, backed by inelastic demand and new product launches, are expected to outperform.

In banking, asset quality challenges far from over

In fiscal 2016, there was a sharp increase in slippages to non-performing assets (NPAs) because of higher-than-expected deterioration in corporate credit quality. Asset quality pressures are expected to continue in fiscal 2017 as CRISIL expects around Rs 2.1 trillion of corporate stressed assets (from the top 100 exposures of all banks) turning non-performing by March 2017.

But regulatory suasion has meant increased recognition of stressed assets by banks. This is narrowing the gap between reported NPAs and weak assets (*Table 3*). Consequently, CRISIL expects overall slippages in the banking system to remain high at 4.2% -- or Rs 3.3 trillion -- for this fiscal, and gross NPAs to increase to 8.5% -- or Rs 7.5 trillion. Further, weak assets are expected to remain high at 9.6% or Rs 8.6 trillion as on March 31, 2017 (around Rs.7.4 trillion as on March 31, 2016).

For public sector banks (PSBs), the spike in provisioning will neutralise profits such that it will equal pre-provisioning profit in the current fiscal. Provisions as a proportion of total assets was high at around 1.6% in fiscal 2016, and will remain at elevated levels this fiscal because of continued high level of slippages, ageing of NPAs, and provisioning towards restructured accounts. Further, net interest margin (NIM) will be under pressure due to loss of interest from accounts slipping into NPAs, the impact of implementation of the Ujwal Discom Assurance Yojana – or UDAY -- scheme for discoms leading to lower yields, and implementation of the marginal cost lending rate mechanism. However, lower cost of funds across is expected to partially offset this impact. Banks have been able to improve their proportion of low-cost deposits and hive off high-cost term deposits given the sluggish credit growth last fiscal. CRISIL expects, of the 26 PSBs, as many as 12-14 to report losses this fiscal, while others would have low profits.

These asset quality pressures will also manifest in higher capital requirement for PSBs. Only 10 out of 26 PSBs are expected to have some capital cushion over the regulatory minimum by the end of this fiscal compared with 25 out of 26 at the end of last fiscal. The banking system will require Rs 3.3 trillion till fiscal 2019 with PSBs requiring the lion's share of Rs 2.5 trillion.

Table 3: The weak assets matrix

Year ended	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17 (P)
Gross NPAs (as a percentage of gross advances)	3.3%	3.8%	4.3%	7.5%	8.5%
RSA (as a percentage of gross advances)	5.0%	5.3%	5.7%	3.5%	2.4%
Weak assets ⁵ (as a percentage of gross advances)	4.3%	5.1%	6.2%	9.1%	9.6%
Gross advances (Rs trillion)	59.7	68.7	75.3	81.1	89.6

⁵ According to CRISIL's definition, weak assets include reported gross NPAs + 40% of restructured standard assets (excluding those of state power utilities) + 75% of security receipts + 15% of loans structured under 5/25 scheme (as per which banks will be encouraged to extend long term loans to infrastructure sector with flexible structuring to absorb potential adverse contingencies)

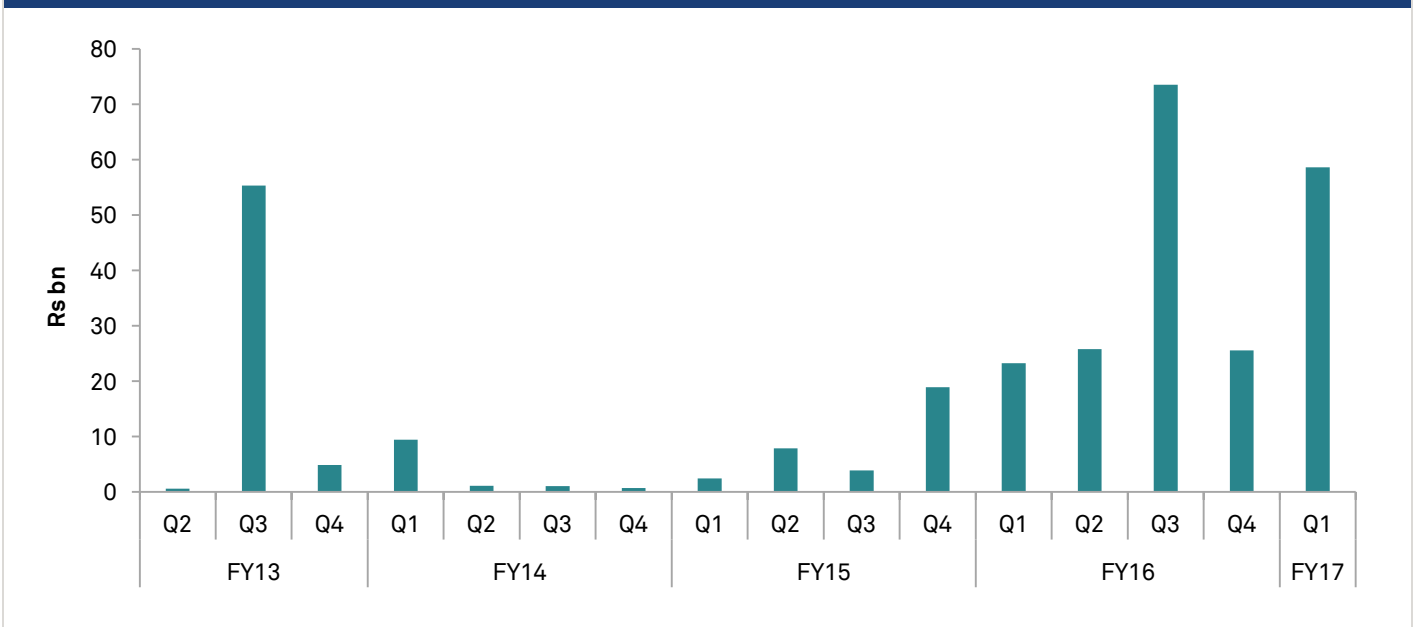
Outlook

Domestic consumption demand is expected to remain the mainstay of India's GDP growth in the current fiscal, driven by private consumption growth and increase in government spending in the first quarter of the current fiscal.

Private consumption is expected to receive a further boost in the coming quarters on the back of expected improvement in rural demand led by a near-normal and well-spread monsoon. After two consecutive years of deficient rains, near-normal monsoon with favourable regional and geographical distribution is expected to lift farm growth and bring cheer to the rural economy. This, together with the implementation of the Seventh Pay Commission and One Rank One Pension (OROP) recommendations augur well for domestic consumption growth this fiscal.

A consistent improvement in private consumption demand, and higher government expenditure should lead to even higher production and capacity utilisation in consumption-linked sectors. For firms in these sectors, profitability will also be buoyed by low input costs stemming from a sharp decline in energy and metals prices over the past two years. With prices now stable at lower levels, profits would improve as would savings. Both these factors, along with improving capacity utilisation, is expected to translate into higher investment spending by the end of this fiscal. The primary equity market has seen a flurry of IPOs by corporates gearing up for an improvement in domestic demand growth (*Chart 7a*)

Chart 7a: Doing well at the primaries



Source: CRISIL

The Narendra Modi government has been pushing reforms and building the confidence of investors. It was able to pass the Constitution Amendment Bill for ushering in the Goods and Services Tax (GST) regime, which would herald a single taxation regime across India and improve the ease of doing business. The government has also been active in resolving issues pertaining to clearances of stuck projects and in providing much-needed support to the roads sector in an attempt to revive the investment cycle. Though funding from banks remain a constraint on account of their extensive exposure to weak assets, indebted companies are seeking traction through asset sales.

Significant headwinds continue in exports with the World Trade Organisation sharply revising its global trade growth forecast to 1.7% from 2.8%. S&P Global, too, has revised its growth outlook lower for India's major trade partners for 2016 and 2017. That would mean not much improvement in India's exports in the current fiscal, with a handful of sectors such as pharmaceuticals outperforming.

Although there are enough reasons for optimism in the second half of the current fiscal and beyond, caution is warranted on these fronts:

- a) any further delay in the investment cycle (caused by policy bottlenecks or inability to deleverage)
- b) delay in policy rate cuts by the Reserve Bank of India, and more importantly in its transmission by banks (which continue to be hobbled by mounting weak assets)
- c) Continuing policy support and implementation of reforms, especially GST
- d) a sharp depreciation in the rupee against the dollar (caused by the huge impending payouts towards foreign currency non-resident deposits or due to an increase in rates by the US Federal Reserve); and,
- e) further slowdown in any of India's major trade destinations.

Key reasons for rating action and credit quality outlook for key sectors

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
Pharmaceuticals	<p>Upgrades were driven by healthy growth in revenues, higher profitability (owing to high export growth, especially to the US) and improvement in financial risk profiles. The bulk drugs sector witnessed maximum upgrades due to better demand in both India and abroad.</p> <p>Close to three-fourths of the downgrades were in the non-investment grade category mainly attributable to business reasons such as intense competition and stretched working capital cycle leading to weak liquidity.</p>	<p>The Indian pharmaceutical industry's revenues are expected to grow at 11.5% to 12.5% over the medium term backed by steady domestic and exports growth. In India, chronic care drugs are expected to drive growth despite them now facing the risk of price interventions from the government. The fixed-dose combination ban, if implemented, could impact 3-4% of the Rs 900 billion revenues of the domestic industry, with impact varying across companies. Higher export growth, especially to the US seen last fiscal, is likely to sustain backed by more ANDA⁶ approvals and new product launches. This will be partially offset by fewer products going off-patent, increasing competition, consolidation of distribution channels and the consequent price erosion in the US. Additionally, players under regulatory scrutiny and dependent on manufacturing plants under regulatory scrutiny will see lower-than-industry growth. Overall, CRISIL expects domestic demand to grow at a faster ~13% compared with ~10% for exports.</p> <p>Notwithstanding regulatory and currency headwinds, large formulators are expected to clock an operating margin of over 20% on account of growth in the US. But increasing research & development expenditure and compliance costs will curb a significant improvement in profitability. Small and mid-sized formulators may witness greater improvement on the back of increased product and geographic diversification. For bulk drug manufacturers, the pressure on profitability continues due to commoditisation of active pharmaceutical ingredients and competition from China. However, these manufacturers benefit from lower crude oil prices, and are consciously rationalising their portfolio to target high-value, low-volume products. This will help them sustain their operating margins.</p>

⁶ ANDA: Abbreviated New Drug Application

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
<p>Agricultural products</p>	<p>Almost half of the upgrades were attributed to improvement in business factors such as better demand and efficient working capital management.</p> <p>Downgrades were on account of a fall in realisations, and lower operating margins (especially for rice players due to decline in rice prices). Almost 50% of the downgrades were to the default category.</p>	<p>India exported 4.04 million tonne (MT) of basmati rice (valued at Rs 227.14 billion) in the last fiscal, which was an increase of 9.1% by volume and a decline of 17.7% by value (3.7 million tonne and Rs 275 billion in fiscal 2015). Clearly, the decline in sales realisation indicates basmati rice exporters faced sales growth challenges. Though lower paddy prices last fiscal helped exporters in lowering their purchase price, it also accelerated the deterioration in credit risk profiles of highly leveraged exporters carrying high-cost inventory from the previous season. CRISIL expects credit risk profiles of basmati rice exporters to continue to show moderate-to-high stress. Export volumes to Iran also reduced sequentially last fiscal for the second straight year.</p> <p>CRISIL expects that India's rice production to be higher this fiscal and basmati rice exports realisations and volumes to improve given its competitive pricing.</p>
<p>Textiles</p>	<p>Around two-thirds of the upgrades were for business reasons such as revenue growth, and higher operating margins. Upgrades were mainly witnessed among cotton ginners and readymade garments makers, which had seen better demand.</p> <p>Downgrades were mostly of yarn manufacturers due to a fall in derived demand and tepid exports. A third of the downgrades were to the default category</p>	<p>Ready-made garments exports are projected to grow at a moderate 4-5% compounded annual growth rate (CAGR) in dollar terms in the medium term compared with 10% seen between 2010 and 2015 because of moderate demand growth in the US and the European Union, lower cost competitiveness (compared with Bangladesh and Vietnam), subdued growth in non-traditional markets and expected stabilisation of the rupee.</p> <p>However, despite pricing pressure, profitability of exporters is seen range-bound because of additional duty drawback benefits by way of refund of state levies extended under the new textiles policy.</p> <p>Increase in volume sales aided by rising incomes and increasing retail penetration would result in relatively higher revenue growth for domestic garment manufacturers. Profitability is expected to remain stable supported by healthy operating rates.</p> <p>Demand for cotton yarn is expected to stay sluggish at 3-4% over the medium term to muted yarn exports and moderation in derived demand. Sharp increase in cotton prices in the second quarter of this fiscal, and reducing spreads between cotton and yarn prices is likely to exert pressure on the profitability of cotton spinners. Lower yarn demand coupled with withdrawal of the Textile Upgradation Fund Scheme incentives for spinners will restrict capacity additions over the medium term.</p>

Ratings

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
<p>Automotive components</p>	<p>Around 40% of upgrades were for business reasons such as volume growth due to better demand from two-wheeler and medium & heavy commercial vehicle (M&HCV) segments. Prudent capital expenditure and working capital management led to improvement in financial risk profiles, particularly liquidity, thus driving upgrades.</p> <p>Downgrades were mostly due to lower-than-expected cash accrual, particularly due to delay in ramp-up of utilisation at additional capacities, and stretch in receivables affecting liquidity. A fourth of the downgrades were to the default category.</p>	<p>The automotive components industry is expected to grow at a healthy rate of 9-11% this fiscal supported by better demand for passenger vehicles (including utility vehicles) and scooters. Further, recovery in rural demand for motorcycles, light commercial vehicles (LCVs) and tractors are pushing up demand for components, even as growth in the M&HCV segment is expected to moderate (compared with the previous two fiscals) due to sluggish economic activity and modest freight rates. Demand growth for components will also be helped by steady replacement demand for automobiles purchased in the past 3-4 years. However, growth in the exports segment is expected to be moderate at 2-4% due to a slowdown in the CV segment in the US and modest demand growth in the UK, Germany, Africa and Latin America.</p> <p>Emerging technologies such as automated manual transmissions, anti-lock braking systems, and electronic control units/sensors hold immense growth potential in the medium term.</p> <p>Raw material prices, which bottomed out last fiscal, are expected to rise 2-3% this fiscal. This is expected to be passed on to original equipment manufacturers (OEMs) with a lag. Along with better utilisation rates, profitability of component manufacturers, therefore, is expected to be stable around last fiscal's 9-11%. Implementation of Bharat Stage IV (BS IV) emission norms for new models would require high-value components, which will moderate expansion of margins over the medium term.</p> <p>Expected growth in OEM demand, which accounts for two-thirds of component demand, should lead to a revival in capex, especially in the second half of this fiscal. Suppliers to passenger vehicles and two-wheelers, which are operating at high utilisation rates, will lead the capex cycle.</p> <p>In the medium to long term, the proposed implementation of safety regulations and BS VI emission norms by the government will entail component firms to upgrade plants and technology requiring sizeable capex. Therefore, over the medium term, automotive component suppliers that had not raised much debt in the past 2-3 years, are expected to see an increase in borrowings to part-fund the capex.</p>

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
<p>Packaged foods</p>	<p>Around 50% of the upgrades are attributable to improvement in business risk profiles: healthy topline due to better demand or volume growth, and better operating margins due to higher pricing supported by improvement in the financial risk profiles due to low gearing.</p> <p>About a third of the downgrades was on account of lower-than-expected revenue growth or orders. Furthermore, around 30% of the downgrades was to the default category.</p>	<p>India's buffalo meat exports saw de-growth of 8.9% in revenue last fiscal, in line with CRISIL's expectations. This came after two consecutive years of good growth (52% in fiscal 2014 and 10.7% in 2015). This was because of a sharp fall in the Brazilian real against the dollar, which made India's exports uncompetitive. India had overtaken Brazil as the largest exporter of beef in the world in 2014. CRISIL expects revenue growth of Indian beef exporters to stabilise at 4-5% this fiscal. Their credit risk profiles may be stable depending on ability to manage working capital cycle through better operating efficiencies and market expansion initiatives. Russia and China are two important destinations having potential for consumption of Indian buffalo meat. However, the government's focus on promoting this category of remains to be seen.</p>
<p>Steel</p>	<p>Half of the upgrades were due to improvement in business risk profiles - healthy topline and strong order book growth. Increase in domestic steel prices owing to government support led to higher realisations.</p> <p>Downgrades were caused by subdued demand because of the slowdown in China leading to lower revenues and profits.</p> <p>The downgraded firms had high leverage; their median debt/EBIDTA was around 5 times compared with 2 times for upgraded firms.</p>	<p>Global steel demand is expected to remain subdued over the medium term because of persistent slowdown in China, which accounts for almost half of world consumption, and sluggishness elsewhere. The Chinese government's efforts to transform the economy from an investment-driven (high steel intensity) one to a consumption-driven one would reduce global steel demand over the medium term. Economic slowdown in major countries is also reducing demand.</p> <p>The interplay of a supply glut, declining input prices and sluggish demand has forced steelmakers in China, Japan, Korea and Russia to aggressively export at lower prices, which is putting pressure on domestic prices. However, with the government setting minimum import price (MIP) for 66 out of 173 products till October 4, 2016 and imposition of anti-dumping duty on hot-rolled coil products (in addition to a tapering safeguard duty), average domestic realisations are expected to increase marginally this fiscal. This, along with a 4-6% expected growth in domestic demand on the back of revival in user segments such as infrastructure and automobiles, expected decline in imports, and few capacity additions, will lead to improving operating rates.</p> <p>All these factors will lend a marginal fillip to profit margins over the medium term. But debt-servicing ability will remain weak given the indebtedness levels.</p> <p>The extension of MIP and anti-dumping duty will remain a key monitorable as it will have a material bearing on the profit margins.</p>

Ratings

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
<p>Construction</p>	<p>Half of the upgrades in this segment resulted from strong order book, providing revenue visibility over the medium term. An increase in construction spending and a slew of policy reforms have improved the business risk profiles of companies and increased operating efficiencies.</p> <p>Downgrades were primarily driven by weak profitability and slow project execution coupled with lower-than-expected revenue growth and stretched liquidity. The median working capital cycle for downgraded firms was 9 months compared with 4 months for upgraded firms.</p>	<p>CRISIL expects construction spending to increase 7%-8% this fiscal after growing 4% in the last, driven by recent push to policy reforms and improving financial health of infrastructure companies. Road projects in particular, which contributes around 40% of construction spending, has received boost from higher budgetary allocation via PMGSY⁷ to improve rural roads and significant expenditure on national highways.</p> <p>The railways sector is expected to get boost as the government increases investments for dedicated freight corridors, new lines and electrification. Investment for bullet trains would also provide an uptick.</p> <p>Investments in the irrigation sector is expected to increase moderately, driven by the top seven states -- Andhra Pradesh, Telangana, Madhya Pradesh, Gujarat, Maharashtra, Karnataka and Uttar Pradesh, which would total up to ~75% of the investments in the irrigation sector. The urban infrastructure sector is expected to continue growing at healthy pace because of government schemes such as AMRUT⁸, Swachh Bharat and Clean Ganga Mission. The development of smart cities and metros would be additional boosters.</p> <p>However, improvement in profitability would be restricted, despite the government's recent slew of reforms to speed up execution resulting in lower overhead expenses and working capital requirements, because of cost overruns in legacy projects and higher interest costs. The recent announcement of fast-tracking arbitration and releasing claims of construction companies is expected to provide some financial relief over the medium term. In the interim, working capital management and debt reduction via asset sales and equity infusion will be the key rating monitorables.</p>
<p>Real estate</p>	<p>Upgrades in this sector were mainly in special purpose vehicles that have seen higher sales or were nearing completion.</p> <p>Downgrades were mainly in the residential development sector due to project delays and weak demand.</p>	<p>The residential real estate sector has been facing headwinds for the past few years, primarily due to weak demand and bearish consumer sentiments. This was reflected in declining sales velocity (both in the last fiscal and in the first quarter of this fiscal), fewer project launches, and large unsold inventories. Consequently, leverage and refinancing needs increased for developers, which they met</p>

⁷ PMGSY: Pradhan Mantri Gram Sadak Yojna

⁸ AMRUT: Atal Mission for Rejuvenation and Urban Transformation

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
	<p>Around 60% of the downgrades were to the default category.</p>	<p>through expensive funding sources, thereby adversely impacting their financial and credit risk profiles. The sustainability and extent of use of these funding sources will be the key monitorables.</p> <p>Demand is expected to remain muted in the near term and recover gradually over the medium term, with sustained improvement in macroeconomic conditions. However, demand is expected to stay strong in the affordable housing segment in Tier II and III cities given the relatively low ticket sizes and strong impetus by the central and state governments under the Narendra Modi government's 'Housing for All' programme.</p> <p>Average capital values across the top 10 cities are also expected to remain range-bound in calendar years 2016 and 2017. Prices in all cities barring Hyderabad are currently well above their 2008 peaks, so there is very little headroom for a material rise in prices over the next two years given the macro-economic environment.</p> <p>In commercial real estate, vacancies have reduced steadily on the back of increasing absorption over the last couple of years and limited additional supplies. Rents have also been rising. Occupancy is expected to stay healthy driven by improving business conditions.</p> <p>The retail sector continues to witness strong traction given the healthy performance of large and established retail malls across the country. Large foreign institutional investors have been scouting for good properties across metros, and large and small cities, given the strong growth potential over the medium term.</p> <p>Real estate investment trusts (REITs) are emerging as an attractive avenue for large developers and investors with income-generating commercial and retail assets, especially after recent clarifications and amendments. This will enable them to monetise assets, while lowering their cost of capital and also diversify their funding source.</p>
Packaging	<p>Upgrades were mainly attributable to improvement in business risk profiles – revenue growth, and higher operating margins.</p> <p>Around 70% of the downgrades were on account of deterioration in financial</p>	<p>The Indian packaging industry, with estimated revenues of ~\$35 billion last fiscal, is expected to see moderation in growth from 12-15% previously, due to a decline in realisations. Continuing growth in FMCG, pharmaceuticals, processed foods, beverages, personal healthcare, and beauty products, will ensure a steady rise in volume</p>

Ratings

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
	<p>risk profiles stemming from weak liquidity.</p>	<p>growth, especially in flexible packaging. Rising disposable incomes, urbanisation, changing tastes and preferences, and favourable demographics will remain the key demand drivers.</p> <p>Profitability, which took a hit last fiscal amid high volatility in crude prices and foreign exchange rates, is expected to remain steady this fiscal with crude prices steady. With large capacities being added, capacity utilisation and working capital management, especially inventory management, will be key monitorable.</p>
<p>Non-banking financial companies</p>	<p>Most of the upgrades were driven by improved business profile and relatively better asset quality and capitalisation.</p> <p>There was only one downgrade in this sector, that, too, because the parent firm was downgraded.</p>	<p>The performance of retail-focussed NBFCs is expected to improve gradually in line with macroeconomic recovery supported by near-normal monsoon. The assets under management of retail NBFCs are estimated to have grown ~17% last fiscal, and CRISIL expects ~20% growth this fiscal. SME financing -- both loans against property and other loans -- is expected rise healthily. Vehicle financing growth should be steady, led by medium and heavy commercial vehicles. After sustained muted growth over the past few years, gold loans are expected to grow at a moderate pace.</p> <p>Asset quality performance of retail NBFCs is expected to stabilise after deteriorating over the past few years, with gross non-performing assets (NPAs) touching a five-year high of around 4.8% as on March 31, 2016. This will be led by the commercial vehicles segment, which is expected to benefit from improved macroeconomic scenario, especially a pick-up in industrial activity. The extent of asset quality improvement may not be reflected in reported gross NPAs because of the transition to more stringent asset classification norms. Gross NPA ratio is expected to be within the 4.7% to 5% range this fiscal.</p> <p>Given increase in delinquencies between fiscals 2012 and 2016, and the consequent increase in credit costs, return on managed assets (RoMA) for retail NBFCs fell to 1.8% last fiscal from 2.3% in 2012. However, RoMA is expected to increase marginally to 1.9% this fiscal supported by lower interest reversals and borrowing costs. Further, the underlying asset quality improvement will partially offset the transition to more stringent asset classification norms</p>

Industry	Key reasons for rating actions in the first half of fiscal 2017	Outlook for the medium term
		<p>NBFCs are augmenting their capital base to support future growth. Gearing, however, is expected to increase as growth picks up. CRISIL, nevertheless, believes that the credit risk profiles of NBFCs will remain resilient, supported by comfortable capitalisation, which provides a cushion against asset-side risks.</p>

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